

**DEPARTMENT OF STATE REVENUE**

**LETTER OF FINDINGS NUMBER: 99-0497**

**Sales and Use Tax**

**For The Period: 1995 Through 1998**

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**ISSUES**

**I. Sales/Use Tax: Pallet Labels**

**Authority:** IC 6-2.5-5-6; 45 IAC 2.2-5-14

The taxpayer protests the assessment of sales/use tax.

**II. Sales/Use Tax: Forklifts**

**Authority:** 45 IAC 2.2-5-8

The taxpayer protests the assessment of sales/use tax.

**III. Tax Administration: Penalty/Interest**

**Authority:** IC 6-8.1-10-2.1; 45 IAC 15-11-2; IC 6-8.1-10-1

The taxpayer protests the assessment of a negligence penalty and interest.

**STATEMENT OF FACTS**

The taxpayer is a book publishing company with a distribution center in Indiana. More facts will be provided below.

**I. Sales/Use Tax: Pallet Labels**

**DISCUSSION**

Books are sent from out-of-state to the taxpayer's distribution center in Indiana. At the Indiana distribution center, books are "stickered according to customer requests/specifications and

packaged according to the customer's orders of assortments." (Per the taxpayer the types of stickers include: price stickers, UPC coding, and department store coding). In order to keep track of books in the stickering/sorting process, the taxpayer places labels on its pallets:

[T]hroughout the various stickering and sorting processes the product is placed into and removed from racks set up to temporary store the incomplete product. To identify where product is in the process and what still remains to be done, *pallet labels are placed on all pallets of product and each time the pallet is removed from temporary storage and something is added or removed from the pallet a new pallet label is attached.* (Emphasis added)

The pallet labels at issue are not incorporated into the product (they are not a material part of the books), and are simply used for inventory/tracking by the taxpayer. Thus the labels do not meet the requirements of IC 6-2.5-5-6, which states that:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business.

Also, 45 IAC 2.2-5-14 states that regarding incorporation the "material must be physically incorporated into and become a component of the finished product." Again, that is not the case with the pallet labels, which are used for inventory control purposes for the taxpayer's convenience.

### **FINDING**

The taxpayer's protest is denied.

## **II. Sales/Use Tax: Forklifts**

### **DISCUSSION**

Taxpayer argues that a large percentage of its forklift usage is to move product within the manufacturing process. The auditor notes that the taxpayer receives a finished product (viz., books) and stickers, assortments, and reboxes the product.

The Indiana Administrative Code (45 IAC 2.2-5-8(f)) specifically deals with forklift usage, noting that a forklift used "exclusively to move work-in-progress from a temporary storage area in a plant and to transport it to a production machine for processing" is exempt usage, whereas a forklift used "exclusively to move finished goods from a storage warehouse and to load them on trucks for shipment to customers" is taxable usage. 45 IAC 2.2-5-8(f)(5) allows that one forklift can be used in an exempt and a non-exempt manner, and thus allows for a percentage exemption

based on the usage. In the case at hand, the taxpayer argues that it is entitled to a percentage exemption.

Taxpayer describes its process, and forklift usage, as follows: product (books) is made out-of-state, and shipped in bulk to the Indiana distribution center. Once the books arrive at the distribution center, forklifts are used to remove the books from the trucks. The books (on pallets) are taken to a temporary storage area. At a later point, the books are moved from temporary storage (again by forklift) and taken to a conveyor line where they will be stickered according to vendor requirements. The forklifts will again move the books back to storage (at this point, for a variety of reasons). Finally, the books are shrink-wrapped and a forklift is used to take them to the shipping area for loading onto trucks to go to the designated vendor.

In order for the forklift usage to be exempt, even on a percentage basis, the taxpayer has to be engaged in production. The auditor contends that the taxpayer's distribution center is not engaged in production. A finished product (books) is brought to the distribution center, and depending on the vendor, a specific sticker is placed on the books. The sticker amounts to a price tag or a price label that is affixed to the final, finished product. The same analysis that was used in finding that the pallet labels are not exempt is applicable here: the pricing stickers are not a material or integral part of the finished product. Given that the stickering of the books does not constitute production, the forklift usage is not exempt.

### **FINDING**

Taxpayer's protest is denied.

### **III. Tax Administration: Penalty/Interest**

### **DISCUSSION**

The taxpayer protests the imposition of the ten percent (10%) negligence penalty. The Indiana Code section 6-8.1-10-2.1 imposes a penalty if the tax deficiency was due to the negligence of the taxpayer. Department regulation 45 IAC 15-11-2 states that negligence is "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer."

Subsection (d) of IC 6-8.1-10-2.1 allows the penalty to be waived upon a showing that the failure to pay the deficiency was due to reasonable cause. In order to establish this, the taxpayer must show that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ." 45 IAC 15-11-2(c).

Taxpayer argues that "The understatements of Use Tax were the result of bona fide interpretations of the tax statute" and not the result of negligence or intentional disregard of the law. This was the taxpayer's first audit; also, the taxpayer did have a self-assessment system for

use tax on out of state purchases.

The taxpayer also protests the imposition of interest. Pursuant to IC 6-8.1-10-1(e) the Department may not “waive the interest imposed under this section.” Taxpayer’s argument on this issue turns on the fact that it has filed bankruptcy (twice). The taxpayer states that “[I]nterest cannot be assessed during the period [the taxpayer] is under bankruptcy protection.” Under Indiana law, the interest cannot be waived.

### **FINDING**

The taxpayer’s protest of the penalty is sustained; the protest of the interest is denied.